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Supreme Court of the United States

OCTOBER TERM, 1926

No. [redacted] 60

BEN W. STEELE, Executor of Estate of A. B. Steele, deceased, Petitioner.

v.

J. H. DRUMMOND, Respondent.

BRIEF FOR RESPONDENT

DANIEL MacDOUGALD,
JOHN A. SIBLEY,
Solicitors for Respondent.

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INDEX.

Page

The Meaning of the Contrast—The Intention of the Parties 1

Steele's Covenant Not Temporary 4

The Contract Is Not in Violation of Public Policy.... 5

The Contract Was Not Illegal and Void from its Conception, as Contended 12

TABLE OF CASES.

	Page
Burbank v. Jefferson City Gaslight Co., 35 La. Ann., 444	9
Cole v. Brown-Hurley Hdw. Co., 117 N. W. 746	9
Cook on Corporations, 8th Ed., Vol. 2	13
Greene v. Nash, 85 Maine 148 (26 Atl. 1114)	9
Hazelton v. Sheckells, 202 U. S. 71	8-10
McGowan v. Parrish, 237 U. S. 285	11
Meguire v. Corwine, 101 U. S. 108	11
Morgan v. Stuthers, 131 U. S. 246	12
Noble v. Meade-Morrison Mfg. Co., 129 N. E. 669	9
Nutt v. Knutt, 200 U. S., 12, 21-2	11
Richardson v. Mellish, 2 Bing., 229	7
Rogers v. Burr, 97 Ga. 10	12
Tool Co. v. Norris, 2 Wall. 45	9-11
Valdes v. Larrinage, 233 U. S. 705	8
Vinton v. Pratt, 117 N. E. 919	12
Waddell v. Railroad Co., 103 U. S. 658	15
West v. Camden, 135 U. S. 507	13
Woodstock Iron Co. v. Richmond & Danville Extension Co., 129 U. S. 643	15

Supreme Court of the United States

OCTOBER TERM, 1926

No. 360.

BEN W. STEELE, Executor of Estate of A. B. Steele, deceased, Petitioner.

v.

J. H. DRUMMOND, Respondent.

I.

THE MEANING OF THE CONTRACT—THE INTENTION OF THE PARTIES

Steele's covenant declared on in this cause is in the following language:

> "The said A. B. Steele further agrees to procure that the said proposed railway company, to be organized as aforesaid in conjunction with the said Atlanta & St. Andrews Bay Railway Company shall operate regular trains over the said two roads from Dothan, Ala., to St. Andrews, Fla., giving to St. Andrews, Fla., the same service at all times as shall be given by the said Atlanta & St. Andrews Bay Railway Company to Panama City for both regular and excursion trains, with equally good rates (as far as permitted by the Public Authorities) for the carriage of both passengers and freight." (R. 18.)

Clearly Steele's covenant related to something that should be done by the proposed Railway Company. He agrees "to procure" that company to give a certain quality of service for a certain period of time. The standard of and the duration of the service that he contracted "to procure" was measured by the standard and the duration of the service that the Atlanta & St. Andrews Bay Rwy. Company rendered to Panama City.

Taking this language at its face value, would require that Steele should procure for St. Andrews, Fla., the same service at all times as the Atlanta & St. Andrews Bay Rwy. Company rendered Panama City.

That the parties meant what they said is emphasized by Drummond's contributions to the enterprise which may be summarized as follows:

(a) Obtained and conveyed to said company a right of way within the City of St. Andrews, Florida;

(b) Paid all cost and damage in obtaining possession of said right of way passing over privately owned lands, and to procure necessary franchises and ordinances from the town of St. Andrews, Florida;

(c) If any land could not be obtained by agreement, the same was to be condemned by the proposed Railroad Company, said Drummond agreeing to stand the expense thereof;

(d) Bore the expense of clearing and grading the whole of said land from Atlanta & St. Andrews Bay Railway to the waters of said St. Andrews Bay, approximately a distance of 3 miles;

(e) Furnished all ties and lay the same and built all necessary trestles and culverts;

(f) Built "Y" of about 3-4 of a mile;

(g) Conveyed, or caused to be conveyed, to the proposed railroad company water terminals fronting 400 feet on St. Andrews Bay and running back about 50 feet to a street.

Drummond performed his obligation at the cost of something over $53,000. The railroad was capitalized at $50,000, and all, or practically all, of the stock was taken by Steele, none by Drummond.

Drummond, in substance, said to Steele:

I am willing to furnish the capital to build the railroad and condition the operation upon the continued operation of service to Panama City.

Steele, in substance, said to Drummond:

I will accept your expenditure of capital and if service is continued to Panama City and discontinued to St. Andrews, Fla., I will return to you the capital that you have invested. Such an agreement on the part of the parties was reasonable under the circumstances.

On the other hand, it would have been unfair and inequitable for Steele to have required Drummond to furnish the capital, given him no ownership in the corporation, and upon failure of service to have left Drummond out of pocket.

Certainly, if Drummond had not placed substantial reliance upon Steele's covenant, an entirely different contract would have been made. Except for this covenant Steele would have offered and Drummond would have required a division of the corporate stock. Such a contract would have equalized the prospects of remuneration.

II.

STEELE'S COVENANT NOT TEMPORARY

The contention is made that the covenant of Steele was temporary and ceased when the corporation was organized. This contention is in the nature of a paradox. The covenant itself, by its express language, deals with a situation that came into existence after the organization of the corporation. To say, that as soon as the condition arose upon which the obligation operated that the obligation itself became extinct, is to bring about an absurd situation.

So, the further contention that the reversionary provision of the deed satisfies all claims in the event of a breach of the covenant would seem unsound.

As to this contention the Circuit Court of Appeals, 11 Fed. Rep. (2nd Series) page 596, said:

> "It is a fair inference that Steele was thoroughly acquainted with the provisions of the deed to his corporation, and it is reasonably to be supposed that the terms expressed in the deed were put in to carry out the intention of the contract, rather than that new or different terms were being agreed upon."

The reversionary provision of the deed, as pointed out by the Circuit Court of Appeals, did not supersede the personal obligation of Steele on his covenant. That provision of the deed in reality merely measured the extent of the corporation's title. The only title that the Railroad Corporation had need of was the use of the land during the continuation of railroad operations—such title only as it could obtain under condemnation proceedings, and that title through condemnation was contemplated, is clear from that provision of the contract as follows:

"And the said A. B. Steele shall cause the said Railway Company when incorporated to condemn any part or parts of such right of way which cannot be procured by private agreement at reasonable cost; the cost of such condemnation within the limits of St. Andrews to be borne by the said J. H. Drummond, including the values of the land so condemned." (R. 17.)

III.

THE CONTRACT IS NOT IN VIOLATION OF PUBLIC POLICY

This contract does not injure the public service. It is in promotion of service to the public; nor does it give to Drummond any advantage over any other member of the public; nor is it an agreement by one person to accept employment of another to influence or procure legislation.

In essence the contract is one in which Drummond furnishes the capital to an enterprise. Steele becomes the owner of the capital so contributed by Drummond. Steele agrees that the capital shall be employed to give a certain quality of service, and failing to give the service, he agrees to indemnify Drummond.

In criticizing that portion of the opinion of the Circuit Court of Appeals, which denies the defendant's contention that the contract is invalid, counsel in their brief, page 6, say:

"The Court failed to note the fact that in this case neither the exact service to be performed by Drummond nor the manner of their performance by Drummond are specified so as to show affirmatively that they are legal. His agreement is not merely one to per-

> form certain legitimate services toward a given end but an absolute agreement to procure results and his compensation is contingent upon his success in procuring the franchise. This very contingency suggests the use of corrupt means, if necessary."

The underlying assumption upon which counsel proceed is that Steele hired Drummond to influence legislation, promising to pay him if his services were successful. No basis for this assumption can be found in the language or purpose of the contract. The contract did not give birth to the relationship of employer and employee. Drummond merely agreed to contribute capital in and to an enterprise in which Steele was primarily interested. Incident to the enterprise a license or franchise to use the public streets necessarily had to be granted by proper corporate authority of the municipality.

The opening paragraph of the contract of June 6th, contains this provision:

> "The said parties desire to enter into the agreement hereinafter set forth for the construction and maintenance of a line of railway from the Atlanta & St. Andrews Bay Railway in Panama City to the town of St. Andrews, the right of way for which is to be provided for by the said parties, the said A. B. Steele (within ten days shall take steps to procure) at his own expense for the said proposed railway, a right of way over that part of its line, lying within Panama City, and the said J. H. Drummond shall within said time take steps, at his own expense, to secure the right of way for said proposed road lying within St. Andrews, Fla., and if at the expiration of said time they are mutually satisfied of their ability to procure said right of way and to carry out the said proposed agree-

ment, they shall then enter into a contract therefor as hereinafter provided." (R. 16.)

As a condition precedent to the binding force of the contract, the parties were given opportunity to ascertain whether the provisions could be carried out, one of the provisions being the obtaining of such franchise.

The power to declare a commercial contract invalid because it violates public policy should be sparingly exercised by Courts. The rule by a Court of respectable authority is thus announced:

> "But further than this, the power of courts to declare a contract void for being in contravention of sound public policy is a very delicate and undefined power, and, like the power to declare a statute unconstitutional, should be exercised only in cases free from doubt.
>
> "In Richardson v. Mellish, 2 Bing, 229, Sir James Burrough is quoted as saying: 'I . . . . protest, as my lord has done, against arguing too strongly upon public policy. It is a very unruly horse, and when once you get astride it, you never know where it will carry you. It is never argued at all but when other points fail'."

The Courts will presume that the contract is valid and that no illegal means are contemplated unless there is something in the contract that carries a different conclusion. The only exception is in those contracts where the general scheme is of a corrupt nature.

There is a sound public policy in permitting a citizen freedom of contract. There is a sound public policy in presuming that the citizen is honest until the contrary is made

to appear by substantial evidence, either within the contract itself, or within the scheme embraced in the contract.

The assumption of false virtue is as harmful as the lack of virtue. Both are unrighteous.

This Court fully recognized in the case of Valdes v. Larrinaga, 233 U. S. 705, that all contracts between parties, the purpose of which is to obtain a concession from the Government or of a department thereof, are not invalid.

The contract there under attack provided that Larrinaga, formerly Assistant Secretary of the Department of Interior, should help in getting through a water franchise for the La Plata River for the purpose of developing electric power and should help in everything concerning the technical part of getting such franchise through, such as plans, project, etc. Larrinaga's compensation was represented by 10% of the profits in the enterprise.

It was insisted that the contract in that case was controlled by the case of Hazelton v. Sheckells, 202 U. S. 71, and similar cases.

In declaring the contract legal and enforceable, this Court on pages 709 and 710 said:

> "But we discover nothing in the language of the letters that necessarily imports, or even persuasively suggests any improper intent or dangerous tendency. * * * * In view of the subject matter, a grant, it would seem to a riparian owner, of the right to use water power for public service, the things done, such as joining in an application to the Military Government for a franchise on the footing of a joint interest, or helping to present it to the Secretary of War when it came up to him, or preparing plans and specifications to be

presented to the Executive Council of Porto Rico when the first franchise granted by the Secretary of War had been lost by not complying with its terms, have no sinister smack."

A well considered case, in which the authorities of this and other Courts are fully reviewed, is that of Noble v. Meade-Morrison Manufacturing Company, 129 N. E. 669.

The Supreme Court of Massachusetts on page 672 in that case enters into a very informative discussion of the entire question here involved.

The case at bar is fully sustained by the case of C. C. Cole v. Brown-Hurley Hardware Company (Iowa—117 N. W. 746) 18 L. R. A. (N. S.) 1161.

That is a well considered case by the Supreme Court of Iowa. See also Burbank v. Jefferson City Gaslight Co., 35 La. Ann. 444; Greene v. Nash, 85 Me. 148 (26 Atl. 1114).

The case at bar is distinguishable from the cases cited by opposing counsel. In Tool Company v. Norris, 2 Wall. 45, this Court had before it a contract originating during the Civil War; Norris agreed to obtain, and did obtain, for the Tool Company a contract for the manufacture of 25,000 muskets, the price of each musket was $20.00. He claimed as compensation for his services all received by the Tool Company in excess of $17.00 per musket. His total compensation amounted to $75,000, according to his claim.

In procuring the contract he used his personal influence with Senators and Government officials.

The question decided by this Court is stated on page 54 as follows:

> "The question, then, is this: Can an agreement for compensation to procure a contract from the Government to furnish its supplies be enforced by the Courts? We have no hesitation in answering the question in the negative. All contracts for supplies should be made with those, and with those only, who will execute them most faithfully, and at the least expense to the Government. Considerations as to the most efficient and economical mode of meeting the public wants should alone control, in this respect, the action of every department of the Government. No other consideration can lawfully enter into the transaction, so far as the Government is concerned. Such is the rule of public policy; and whatever tends to introduce any other elements into the transaction, is against public policy. That agreements, like the one under consideration, have this tendency, is manifest. They tend to introduce personal solicitation, and personal influence, as elements in the procurement of contracts; and thus directly lead to inefficiency in the public service, and to unnecessary expenditures of public funds."

Hazelton v. Sheckells, 202 U. S. 71. In that case Hazelton prayed for the specific performance of a contract for the purchase of a lot in Washington. His bill alleged that part of the consideration entering into the sale of the lot consisted in services rendered by him, both before and after making the contract, in bringing the property to the attention of Committees of Congress as a suitable and appropriate site for a Hall of Records. He further alleged that these services had been successfully performed.

In declaring the contract void this Court on page 78 said:

> "According to the bill, and no doubt according to the fact, a part of the consideration was services, as

we have quoted, and therefore it is not true, as argued, that the plaintiff could have demanded a conveyance on tendering the nine thousand dollars alone. But the services contemplated as a partial consideration of the promise to convey were services in procuring legislation upon a matter of public interest, in respect of which neither of the parties had any claim against the United States. An agreement upon such a consideration was held bad in Tool Co. v. Norris, 2 Wall. 45. Of course we are not speaking of the prosecution of a lawful claim.

"It will be noticed further that the conveyance was in substance a contingent fee. The plaintiff was not bound to accept it and naturally would not do so unless he could agree as he did with the Government for a larger price. The real inducement offered to him was that he would receive all that he could persuade the Government to pay above the sum named."

In the case of Meguire v. Corwine, 101 U. S. page 108, plaintiff claimed that he had obtained a public office for defendant; that the defendant agreed to pay him for such services one-half of defendant's compensation. The contract was declared illegal as constituting a sale of personal influence.

Since the rendition of the decision in the case of Tool Company v. Norris, supra, this Court has permitted contracts to stand, which under the broad language of the Norris case would have been struck down.

See Nutt v. Knut, 200 U. S. 12, 21 and 22; McGowan v. Parish, 237 U. S. 285.

IV.

THE CONTRACT WAS NOT ILLEGAL AND VOID FROM ITS INCEPTION, AS CONTENDED.

This is not a contract where an officer of a corporation agrees in consideration of a benefit to him to have the corporation, of which he is an officer, employ a third party; nor is it a contract in which one who occupies a fiduciary position, in consideration of a private benefit to himself, assumes an inconsistent position towards another; nor does it create a dual agency whereby an agent obtains secret profits at the expense of the principal.

In essence it is an agreement by one person to protect the capital investment of another, under certain contingencies. Such agreements frequently arise where one stockholder agrees to purchase the stock of another stockholder in the event the corporation fails to pay dividends, or in the event the corporation becomes insolvent. These agreements are universally upheld by courts.

In Morgan v. Stuthers, 131 U. S. 246, this Court upheld a contract against the contention that it was contrary to public policy, wherein it was provided that B & S in consideration of the subscription of stock by M would purchase M's stock should M desire to sell.

An agreement of the same nature was enforced in the case of Rogers et al v. Burr, Administratrix, 97 Ga. 10.

In Vinton v. Pratt, et al, 117 N. E., page 919, the Supreme Court of Massachusetts held that:

> "One who took stock in a gold mining company under agreement that the organizers should save him harmless on the investment, guaranteeing repayment of the money with interest at 6 per cent, the capital stock having become worthless, could have sued at law

for reimbursement of the amounts advanced by him, with interest."

In Cook on Corporations, 8 Ed. Vol. 2, pages 1227, 1228 and 1229 many cases are cited upholding such contracts.

None of the cases relied upon by the petitioner are applicable to the case at bar:

The facts in the case of West v. Camden, 135 U. S. 507 are clearly distinguishable from the facts in the case at bar. In that case West, the plaintiff, was originally a member of the partnership of C. W. West & Sons; that company sold its holdings to the Baltimore United Oil Company, a corporation, for $137,500, and West also subscribed for 457 shares of stock in that company. Out of the 6000 shares, which constituted the capital stock, 5509 were subscribed to by the defendant, Camden, as Trustee for the Standard Oil Company, who furnished the money and was the real owner. Camden occupied the position of President of the new company and West Vice-President until January 1883, when a change in management occurred and West was dropped as an officer. West knew that Camden was the agent of the Standard Oil Company in subscribing to the capital stock and in the organization of the new company.

Having lost his position, West sued Camden for $50,000.00, claiming that Camden, as part of the consideration for the original sale of the property from C. W. West & Sons to the new corporation, agreed to employ West as Vice-President of the company permanently.

The contract was declared void as contrary to public policy. The basis of the Court's decision will be found on page 520, as follows:

"The agreement alleged to have been made was one on the part of the defendant whereby he might be required to act contrary to the duty which, as an officer of the Baltimore United Oil Company, he owed to that company and to the stockholders other than the plaintiff. The same rule which is applicable to the case of a public office applied to the present case, although it does not appear that the defendant was to receive direct personal pecuniary compensation or gain for what he was to do. The plaintiff, on his own showing, dealt with the defendant in reference to the fiduciary relation which the latter bore to the stockholders, both of the Standard Oil Company and of the Baltimore United Oil Company. The agreement alleged was an agreement which bound the defendant as to his future action as a director of the Baltimore United Oil Company, and an agreement to keep the plaintiff permanently in the position of Vice-President of that company, irrespective of its interests. It amounted to a stipulation on the part of the defendant that no contingency should happen which should require a change of management and a reduction of expenses."

In that case, Camden as an officer of the Oil Company, stood in a fiduciary relation to the Company. As Trustee of the stock he also stood in a fiduciary relationship to that Company. Any contract he made where his individual interests were involved, that limited his freedom of action in the discharge of his duty as President of the Company and in the discharge of his duty as voting Trustee necessarily was immoral and corrupt in its tendency.

The law has ever denounced contracts between parties, the object or purpose of which would bring about or tend to bring about a breach of duty.

In Waddell v. Railroad Company, 103 U. S. page 658; the Directors of the Railroad Company, entered into a contract in which they were to receive private gain and in order to shield their actions a corporation was organized to carry out the contract and the Directors became stockholders. The contract was denounced by the Court, and properly so.

In Woodstock Iron Company v. Richmond and Danville Extension Company, 129 U. S. 643, an employee of a railroad company accepted a consideration from the Iron Company for locating a line of railroad at a point desired by the Iron Company. In denouncing the contract this Court held:

> "It was a contract by an employee of a railroad company with a third party, for a consideration to be received from that third party to violate its engagement with its employer in the important business of locating and constructing a railroad, and instead of selecting the shortest, cheapest and most suitable route, to locate the road by a longer route, and thus impose an unnecessary and heavy burden upon its employer—the proposition of the Iron Company, which was accepted, was to pay the extention company for a breach of its duty. In plain language, it was nothing less than the offer of a bribe to the latter company to be faithless to its engagements, and to do with reference to the business in which it was engaged what would amount to little less than robbery of its employer. The transaction of the Iron Company was none the less offensive, because of the threats of the Extension Company, made by its Vice-President, who was also a director and stockholder of the railroad company, that, if the land and money mentioned were not donated, it would cause the railroad to be located away from Anniston by the rival town of

Oxford. The threats did not excuse, much less justify the offer."

Men of full age and competent understanding should have the utmost liberty to contract, and contracts entered into freely and voluntarily should be held sacred and enforceable by the Courts.

Respectfully submitted,

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JOHN A. SIBLEY,

Solicitors for Respondent.